official company document.[32] In fact, ASI personnel went so far as to explain to certain members of the audit team how the unofficial translation table was incomplete.

The official translation tables are part of the AOCs' financial accounting computer system. Each ASI bill line and product line code is automatically translated into the proper Part 32 Account and Part 64 cost pool within the financial accounting computer system operated by the AOC when the bill is received from ASI. Therefore, once the function codes and cost pools are assigned to the bill lines and entered into the computer system, the translation is done automatically. The fact that an employee does not have a complete translation table does not in any way mean that the costs were not allocated to the proper Part 32 accounts and Part 64 cost pools.

3. The audit team had all the information necessary to determine how ASI allocated its costs between regulated and nonregulated operations.

Through the presentations and the answers to data requests, ASI provided the audit team all the information it needed to complete the first task, i.e., understand how ASI's accounting procedures worked and how the costs were allocated. ASI gave the audit team several different billing and financial reports such as the Cost Allocation Tracking System (CATS) 1170 and 9240 reports, which contain all ASI's cost information by bill line, work profile and AOC.[33] The 1170 report also listed product line codes and function codes assigned to each bill line. Consequently, the audit team should have been able to follow the costs as they were accumulated on ASI's books under a project code and bill line to the work profile.

Then the audit team should have used the official translation tables to determine the Part 32 account and Part 64 cost pool the costs were assigned. While the report continues to claim that it had incomplete translation tables, ASI has already demonstrated that claim false. Moreover, the audit team itself demonstrated its ability to track ASI's costs to the Part 32 account and Part 64 cost pool, by compiling a chart containing all the bill lines, costs, Part 32 accounts, and Part 64 cost pools for the Ameritech Integrated Marketplace System (AIMS) work profile.[34] The report's six other findings are additional evidence that the audit team had the ability to track ASI's cost allocation.

[32] See Exhibit 5 for affidavit from Mr. Mihina.

[33] See Exhibit 6 for a list of all the financial and accounting reports provided to the audit team.

[34] Report at page 15.

Based on this information, the audit team -- without question -- had sufficient information to determine how ASI accumulated and allocated its costs.

C. Task 2: The Audit Team had More Than Sufficient Information to Evaluate Whether ASI's Cost Allocations Were Reasonable.

Having determined what Part 32 account and Part 64 cost pool ASI's costs were allocated to, the second task for the audit team was to evaluate whether these classifications and allocations were reasonable. Ameritech suspects that it was in this area the audit team lost the thread of its audit.

As support for Finding 1, the audit team claims that ASI had insufficient written documentation. The audit team found that ASI's benefit verification forms could have provided more extensive information. In addition, the team claims that in its attempts to interview work profile managers, many of the managers had left Ameritech or had changed job functions. Finally, the audit team claims that because ASI did not have written descriptions of how it distinguished between billable and nonbillable work profiles, or in ASI's terminology direct and indirect, the audit team could not determine whether the allocation between billable and nonbillable was consistent with the Commission's affiliate transaction rules.

However, nowhere in the discussion regarding this finding does the audit team list any specific facts supporting its conclusion. For example, there is no reference to which particular documents contained limited information; no reference to which work profile manager was unable to answer what specific questions during the interview; and no reference whatsoever to the approximately 100 questionnaires completed by ASI and AOC employees. Instead, the audit report paints the audit information with broad allegations.

1. The audit team was provided sufficient written documentation.

The audit report fails to take into account the substantial information ASI provided to the audit team. In this regard, the audit team had a work profile form that included, at a minimum:

- a description of the work to be performed;
- a list of deliverables or tasks that needed to be accomplished on a quarterly basis;
- a list of assumptions or prerequisites necessary for the work to be accomplished; and
- the administrative process that the work supported.

In addition to the work profile form, for those 16 work profiles the audit team selected for more detailed review, the audit team had further information available, such as:

- business case analyses for strategic work profiles;
- examples of ASI employees' work product;
- examples of ASI employees' job descriptions;
- ASI and AOC employees' completed questionnaires; and
- ASI and AOC employee interviews.

ASI has re-cataloged the information provided to the audit team by the 16 different work profiles, and compiled the information into separate binders. ASI has already reviewed a binder containing all the information on the Ameritech Integrated Marketing System (AIMS) with the FCC member of the audit team as an example of the substantial information that was provided during the audit.[35] These other binders are available and clearly demonstrate that the audit team had the necessary information to review the reasonableness of ASI's cost allocations.[36]

2. The report's characterization of the managers' interviews is inaccurate.

Another example of the audit team's inaccuracy is its claim that the interviews conducted provided little information about ASI's cost allocations. But, nowhere in the report is there any discussion of the facts supporting the audit team's conclusion. There is no discussion regarding:

- which managers could not be interviewed;
- which managers interviewed could not provide complete answers to questions; and
- which questions could not be answered completely.

According to ASI's records, the audit team was able to interview 29 of the 40 work profile managers requested by the audit team. Moreover, the audit team interviewed another 30 managers who represented the 16 work profiles the audit team selected for more detailed review. It is inconceivable that 59 employees of ASI, who had significant responsibility to complete the work encompassed by the work profile and whose continuing employment was

[35] See Exhibit 7 for a List of the information contained in the AIMS binder.

[36] See Exhibit 8 for a list of the supporting documentation provided for each of the 16 work profiles selected by the audit team.

contingent on accomplishing that work, did not provide sufficient information to explain the cost allocations.

3. The audit team had information about the benefits of ASI's services to the AOCs.

Again the report misrepresents the type of information it had on which to base an evaluation of ASI's cost allocations, by claiming that ASI could have maintained more extensive information about the benefit to the AOCs of different services provided by ASI. The audit team fails to articulate the Part 32 or Part 64 rule which requires the AOCs to demonstrate that the services provided from ASI were beneficial to the AOCs. In this regard, neither Part 32 nor Part 64 of the Commission's rules establish any standard by which to make a qualitative or quantitive evaluation of the products and services provided by affiliates. Rather, Part 32 and Part 64 rules require the proper recording and accounting of regulated and nonregulated costs. The rules do not address whether those costs are reasonable.

Also, the audit team had substantial information in addition to the benefit verification forms about the 16 work profiles from which it could determine whether ASI's work benefited the AOCs. Specifically, much of the work conducted by ASI is done at the direction of strategic initiatives which are approved by ASI board members. Since the ASI board members are all officers of the AOCs, the major projects performed by ASI on behalf of the AOCs, such as data consolidation and IT work, are already deemed beneficial and reasonable through the strategic initiative approval process.[37] In fact, the audit team was aware of all strategic initiatives and asked detailed questions on many of them.

In addition to those strategic initiatives, the audit team had additional information about the appropriateness of ASI's work packages. The audit team had studies completed by both Peat Marwick and Real Decisions regarding ASI services.[38] The Peat Marwick study assessed the reasonableness of AIT's and ASI's charges, which encompassed the total cost Ameritech Corporation and ASI allocated to the AOCs. The Real Decisions study compared the unit cost of certain information technology services performed by ASI to the costs of similar services provided by other companies. And, not only did the audit team have copies of these studies, it asked several detailed

[37] Presentation on AMP by J. Lenahan in July, 1992, and the audit team received a copy of the AMP process June 5, 1992.

[38] January 26, 1993, FCC data request No. 1, Question 5; and January 27, 1993, data request No. 3, Question 10.

questions regarding them.[39] Finally, the audit team had information about benchmarking studies that were completed internally.[40]

Thus, the audit team had all the types of information listed above which not only provided information about the products and services but also provided information about the reasons for doing the work and the benefits that would arise. Based on all this information, the audit team has failed to provide a reasoned basis for its conclusion that ASI should have provided more documentation on the benefits of its services to the AOCs.

4. The audit team did not need written explanations about how ASI classified billable and nonbillable work profiles to evaluate the reasonableness of that classification.

The audit team did not need written explanations of how ASI classified its work profiles into billable or nonbillable profiles, or using ASI's terminology, direct and indirect work profiles. The audit team claims without those written explanations it cannot evaluate the reasonableness of the allocation of the costs between overhead and direct billed. However, as noted above, the audit team had a complete list of ASI's work profiles which included information about which were directly billed to the AOCs and which were indirectly billed. Since the audit team not only knew which work profiles were indirectly billed, and had the completed work profile and additional supporting information, the lack of ASI's written description should not have prevented the team from making its own independent evaluation as to whether those work profiles should be considered overhead expenses.

5. The audit team had sufficient written documentation to understand ASI's allocations and Finding 1 is not supportable.

The audit team clearly misrepresents the amount of information it received during the audit. The audit team was able to conduct interviews with work profile managers, and had information regarding the benefit of ASI's services to the AOCs. For all work packages, the audit team received a work profile form which included a description of the work to be performed, the deliverables/objectives to be accomplished under the work profile per quarter, and the necessary assumptions/prerequisite needed for the work to be done.

Moreover, for those 16 work profiles the audit team selected for review, the work profile was not the only information the audit team had available to

[39] September 10, 1993 data request at page 10, a-i, and f; and October 29, 1993 follow-up data request at page 8, a-i, and f.

[40] January 26, 1993, FCC data request No. 2, page 1, Question No. 7, page 2, Questions 4-5.

evaluate the allocation of the work profile costs. For any of the 16 work profiles received by the audit team, the audit team had available any of the following information:

- business case analyses for strategic initiatives;[41]
- interviews with work profile managers and employees;
- questionnaires, formulated by the audit team and completed by employees chosen by the audit team;
- specific job descriptions;
- project descriptions for IT projects;
- work product of employees who were interviewed; or
- benefit verification forms.

The audit team cannot simply ignore the fact that this information existed for at least 16 work profiles. GAAS requires that the audit team evaluate and examine all information in an unbiased manner. The audit team cannot pick and choose which information to accept without articulating a reasoned basis for rejecting the information.[42]

Furthermore, an important part of the audit team's work and review efforts involved employee interviews and questionnaires. In this regard, the audit team, having received an ASI work profile expense report, selected employees to interview based on which employees charged a substantial number of hours to the work profile.[43] In these interviews the audit team requested ASI employees to bring an example of their work product, and the audit team had the opportunity to ask questions about the employees' work efforts.

In addition to personal interviews, the audit team also selected a number of employees to fill out questionnaires; again based on the hours the employee charged to specific work profiles. These questionnaires asked

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[41] And, the audit team knew which work profiles were strategic initiatives, see FCC data request June 2, 1993, Attachment 5, Question 3, "please provide a list of all work profiles that were considered to be ABG strategies and the level of funding that was approved for those projects in 1992."

[42] For those work profiles that were not the 16 selected by the audit team, the audit team may have had only the work profile. Of course, the work profile alone may not provide sufficient information to determine the cost allocation of the work profile. But if that is the case, then the audit team had the responsibility to obtain additional information.

[43] July 22, 1992 data request, Questions 1 and 2; July 30, 1992 data request; July 31, 1992 data request Question 4; January 26, 1993 data request No. 2, at page 2, Question 2; May 12, 1993 data request Question 3; and April 9, 1993 data request Question 4.

employees basic questions such as: 1) a description of their duties under the work profile; 2) a description of the work profile, deliverables, and milestones; 3) whether the employee was supervised or approved the time reporting of other employees under the work profile; 4) a list of all projects the employee worked on; 5) how the employees recorded their time; 6) how the employee kept track of their time to assign to each profile; and 7) a request for the employees' work product. The audit team received answers to these questions.[44]

The report completely ignores the fact that all this information existed and was in the possession of the audit team, along with the myriad of answers to data requests.[45] Instead, the audit report attempts to dispense with all of this supporting information with generic complaints that the documents were insufficient.

Based on GAAS, the audit team has the responsibility to assimilate all the information it has gathered during the audit and make a reasoned evaluation as to whether that information supports ASI's classification of its costs. The audit team must provide a better explanation as to how ASI's records were insufficient, but more importantly why the information ASI provided during the audit was inadequate to allow the audit team to review ASI's cost classification. Under GAAS, the audit team cannot merely pick and choose which information it will accept and which information it will ignore.

In the foregoing sections, ASI has demonstrated that each basis for Finding 1 is not well grounded in fact. Specifically, it demonstrated that:

- the audit team had substantial information about ASI's services;
- the audit team interviewed about 59 employees and received over 98 employee questionnaires, who again provided substantial information; and
- the audit team did not need the written procedures to determine the reasonableness of ASI's separation between billable and nonbillable work profiles.

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[44] However, the questionnaires also asked questions such as: 1) could your work have been done by an outside vendor; 2) do you foresee any future uses for the work by the BOCs or other subsidiaries; and 3) are any nonregulated applications possible. Because these questions were speculative in nature, the audit team often received "I don't know" as the answer.

[45] Again, see Exhibit 8 for a list of the supporting documentation provided for each of the 16 work profiles selected by the audit team.

Based on this information, the audit team failed to provide a reasoned analysis supporting its finding. As noted above, GAAS requires that an auditor assimilate and evaluate all the information it has in order to form an unbiased opinion. The audit team had -- without question -- the ability to track ASI's costs from project code and bill line to Part 32 and Part 64 classification for any work profile.

The audit team also had -- without question -- substantial information to determine the reasonableness of the classifications for at least the 16 work profiles it selected. If the audit team did not have sufficient information to determine the reasonableness of the allocation of the other work profiles, it was the responsibility of the audit team to gather sufficient information.

Since the audit team fails to provide a factual basis for Finding 1, this finding is not supportable. If however, the audit team responds to ASI's comments with factual details supporting its conclusions, ASI must be given an opportunity to respond.

IV. Finding 2: The Costs of the Data Center Consolidation Were Appropriately Allocated Among the AOCs.

The report claims that ASI directly billed the AOCs for certain expenses that should have been billed as an overhead expense, and thus should have been allocated between regulated and nonregulated affiliates.[46] Specifically, the report states that although ASI billed the nonregulated affiliates for the work performed for data processing services, the bills to the nonregulated affiliates did not include costs for the consolidation of specific data centers.

The report provides no explanation as to why these costs should be considered overhead expenses. Nevertheless, as explained below, ASI appropriately billed the data processing costs in work profile 090006, Data Center Consolidation. ASI treats these expenses as direct expenses and bills all the AOCs directly. Similarly, ASI bills nonregulated affiliates directly for the data processing work performed for the nonregulated affiliates on a fully distributed basis, which amounted to $1.08 million in 1992. This work primarily involved running their software on regional computer equipment. The billed amounts included an appropriate pro-ration of all computer operation costs of the site at which the program was run, including the costs of personnel running the machines, depreciation of the hardware, software licenses, and costs of related data processing supplies such as paper, disks, and tapes.

[46] Report at page 22.

The data consolidation costs which the report claims were overhead, were those expenses which were caused by the consolidation of data centers throughout the Ameritech region, and which would not have been incurred absent the consolidation project. These costs amounted to approximately $20 million in 1992. The closings of the AOC data centers benefited the AOCs by reducing the expense associated with their operation. In fact, during the audit, the audit team asked over 112 questions related specifically to the consolidation of data centers, in many cases focusing on the benefits of the consolidation project.

As noted above, the nonregulated affiliates were directly billed for their data processing costs through fully distributed costs based on their usage of the data processing services. Nonregulated affiliates did not own or operate any of the investment in those data centers and had no control over the expenses, but instead were treated as any third party using the data processing services. Therefore, the data center consolidation costs were appropriately billed to the AOCs, and not the nonregulated affiliates. In fact, the report provides no explanation on why the data consolidation costs should have been defined as overhead expenses.

In any event, even if the nonregulated affiliates were billed for the $20 million data center consolidation costs; based on their percentage of using the data processing services, they would have been billed $ 170,000.[47]

V. Finding 3: ASI Properly Assigned the Costs of the Work Profiles Cited in the Report.

In Finding 3, the report states that ASI assigned all costs of the developing new products and services to regulated operations. However, the report claims that the new products and services studied under these work profiles might be offered as either regulated or unregulated services. Thus, the report concludes these seven specific work profiles were improperly assigned to regulated operations:

- 060087 -- Ameritech Directory Search;
- 060088 -- Marketing New Applications Development;
- 060092 -- New Product Development;
- 060093 -- New Products - CIS, CNAM, Video;
- 100009 -- Speech Technologies Evaluation;
- 100010 -- Video Conferencing Prototype: and
- 100017 -- Human Factors Technology.

[47] See Exhibit 9 for an explanation of the calculation of $170,000.

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- 100010 -- Video Conferencing Prototype; and
- 100017 -- Human Factors Technology.

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Based on these findings, the report also concludes that ASI is "biased" against assigning costs to nonregulated activity, and that it "disregards" reasonable cost allocation methods for new products and services.[48]

Ameritech strongly disagrees not only with this finding but with many of the statements and conclusions on which this finding is based. First, the report is inaccurate because not all the costs of these work profiles are assigned directly to regulated operations. For two of the work profiles, a small portion of their costs were assigned to a nonregulated cost pool, while in a third work profile none of the costs were directly assigned to regulated activities, but the majority of the costs were assigned to a shared cost pool and a small portion to a nonregulated pool.

Second, the audit team provides no reasonable basis for its conclusion that nonregulated activities benefited from the work encompassed by the profiles. In fact none of the work profiles cited in Finding 3 were one of the 16 work profiles selected by the audit team for in-depth review. Consequently, the audit team had little information about these work profiles on which to base its "belief" that nonregulated activities benefited.

Furthermore, in more detailed discussion below, a review of the information on the work profile provides persuasive evidence that a majority of the costs of these work profiles were appropriately assigned to regulated operations. If the audit team had doubts as to the reasonableness of the allocation of these costs, GAAS requires the audit team to gather additional information to corroborate its finding. Unless the audit team can provide additional evidence that the costs were misallocated, Finding 3 must be rejected. If however, the audit team responds with specific facts which underlie its conclusion, then Ameritech must be given another opportunity to refute this Finding.

A. The Costs of Ameritech Directory Search Were Appropriately Assigned.

The report correctly states the costs of Ameritech Directory Search were assigned to regulated operations. The reason for this assignment is apparent in the first sentence of the profile overview section on the work profile form: "Ameritech Directory Search is a tariffed service ...." This statement alone supports a direct assignment to regulated operations. Specifically, the work profile states that

[48] Report at page 8, 23.

This work profile enables ASI to act as the service provider on behalf of the AOCs', e.g., maintain the system, tables, files, interface, bill the customer for the service, etc.

The audit team fails to provide any additional information that contradicts the information in the work profile, and therefore has no basis for claiming that nonregulated activities benefited. In fact, the audit gives no explanation to support its conclusion. Consequently, the costs for this work profile were appropriately assigned to regulated operations.

B. The Costs in Marketing New Applications Were Appropriately Assigned.

The report claims that all costs of work profile 060088, Marketing New Applications were assigned to regulated operations. That is incorrect; a portion of the costs of this work profile were directly assigned to a nonregulated cost pool. And, a review of the information on the work profile supports this assignment, i.e., a majority of the costs to regulated and some to nonregulated operations. The activities encompassed under this profile were marketing personnel interacting with network personnel and outside vendors to increase the usefulness of different products.[49] The deliverables and measurable benefits in the work profile list such activities as "assisting in testing, quality assurance, and tariff development for additional ISDN PRI services," and "introduc[ing] SCAI as an enhancement to existing network offerings."[50] This information on the work profile clearly explains that a majority of the work to be performed by the marketing personnel was related to regulated services, and that work related to nonregulated products was directly assigned to nonregulated operations.

Consequently, this information justifies the allocation of this work profile between regulated and nonregulated operations. The audit team provides no evidence other than "belief" that nonregulated activity benefited beyond the direct assignment to nonregulated. Therefore, this finding must be rejected.

C. The Costs of New Product Development Technical Support Were Appropriately Assigned.

The costs of New Product Development Technical Support were appropriately assigned to regulated operations. This work profile directs the activities for network personnel in the marketing organization to assist in the technical support of new products. The new products listed in the work

[49] Work Profile, Description of Proposed Work at page 2 and 2A.

[50] SCAI is an acronym for Switched to Computer Application Interface, and PRI is an acronym for Primary Rate Interface.

profile include 800 database, ISDN, LIDB, AIN, SMDS, and CCSAC.[51] Clearly the majority of those services are regulated, and therefore legitimately assigned to regulated operations.

Moreover, even including SMDS and PCS does not mean some of the costs should be assigned or allocated to nonregulated activities. Specifically, the work under this profile involved the technical work necessary to make the public switched network compatible with the provision of these services. In other words, although the provision of these services themselves would be considered nonregulated, the AOC network has to be technically capable of interconnecting with the providers of these services so that their customers can complete their calls. This interconnection would be a type of access service and offered as a regulated service. Therefore, developing and enhancing the public switched network for that ability is a legitimate regulated cost. Consequently, the costs of this work profile were assigned consistent with the FCC's rules.

D. The Costs of New Products Were Appropriately Assigned.

The report claims that all the costs billed to work profile No. 060093, New Products were assigned to regulated operations. That is incorrect; a portion of the costs were assigned to nonregulated operations. However, nobody denies that a majority of the costs in this work profile were assigned to regulated operations, but like the assignment of Ameritech Directory Search the reason is obvious. These new products are all tariffed services. Specifically, this work profile directs the activities for the analysis, development and implementation of three new products, calling name delivery (CNAM), caller ID (CID) and video bridge. The work profile even lists the approval of caller ID tariffs and a CNAM trial tariff as prerequisites for success of this work effort. Moreover, one of the deliverables for the 3rd quarter of the work profile group was filing the video bridge tariff. Based on the foregoing information, the substantial majority of the costs in this work profile were appropriately billed to regulated operations, and the audit team fails to articulate a reasoned basis for its conclusion that nonregulated activities benefited by any more than was allocated.

E. The Costs of Speech Technologies Evaluation Were Appropriately Assigned.

The costs of Speech Technologies Evaluation, No. 100009 were appropriately assigned to regulated operations. This work profile directs the

[51] ISDN stands for Integrated Services Digital Network. LIDB stands for Line Information Data Base. AIN stand for Advanced Intelligent Network. SMDS stands for Switched Multimegabit Data Service. CCSAC stands for Common Channel Signaling Access Capability.

activities for developing speech recognition and verification technologies in the public switched network. It is based on the assumption that many new services offered by others will require network based speech output and input technologies. For example, Sprint has begun to offer services which recognize speech and simple commands. Although ASI's efforts in this area are similar to Sprint's, since the project is focused on developing and deploying capabilities in the public switched network, it is entirely appropriate to assign the costs to regulated operations.

In any event, if the audit team doubted whether the assignment of these costs to regulated operations was reasonable, based on GAAS, the audit team had the responsibility to gather additional information to corroborate its "belief." In this case, the audit team's interpretation of the work profile as the only evidence regarding this work effort is insufficient to support a finding that assigning the costs of this work profile to regulated operations was improper.

F. The Costs of Video Conferencing Prototype Were Appropriately Assigned.

The costs of Video Conferencing Prototype, No. 100010, were appropriately assigned to regulated operations. This work profile directs the activities for developing the public switched network to use with video applications. Specifically, the work effort involved studying the use of the AOCs' current services, both dedicated and switched, to determine how they were used with the video application and how they could be better used with the video application. Since video services are merely a specific type of application for tariffed services, as compared to digital transmission or voice transmission; it is appropriate to assign these costs to regulated operations. Even though this information was not fully explained in the Video Conferencing work profile, information about video services and how they were provided was available in other documents that the audit team had.[52] Since this work effort is designed to enhance the use of tariffed services through additional applications, it is properly assigned to regulated.

[52] See Ameritech Video Information Kit, Ameritech Services, dated August, 1992, at page 3-5. For example at page 5 the document explains that "Ameritech provides several digital services that can be used in conjunction with CPE to provide video service." See also, An Ameritech Non-Broadcast Video Service Strategy, Ameritech Services Marketing, dated October 14, 1992, at pages 2-4. This document at page 2 states: "video teleconferencing has gained increased demand as an application using our existing product lines such as DS1, ISDN, and OPTINENT Base Rate (56/64 Kbps)."

G. The Costs of Human Factors Were Appropriately Assigned.

The report claims that all the costs of Human Factors, No. 100017 were allocated to regulated operations. That statement is incorrect; the majority of the costs incurred under this work profile were assigned to a shared cost pool.[53] This work profile directs the activities for providing technology support for some Ameritech internal projects that have not been identified in a specific profile. In this regard, the work focused on assisting parties to develop and test new systems, many of which were internal to the company. Through Human Factors testing, the products will increase customer satisfaction and usefulness. Some of the products supported were internal products such as SCOUT, APROMS, and ACIS.[54] Given the rather fluid nature of the work encompassed by this work profile and the fact that the systems supported both regulated and nonregulated work efforts, it is entirely appropriate that the majority of the costs be assigned to a shared cost pool. Since the costs were not allocated solely to regulated, the audit team's finding regarding this profile should be dropped.

H. ASI is Not Biased Against Assigning the Appropriate Level of Costs to Nonregulated Operations.

Based upon the foregoing discussion, the audit team not only failed to provide a reasoned basis to support its findings that these seven work profiles were improperly assigned or allocated; but also failed to provide any evidence supporting its conclusion that ASI is "biased" against allocating costs to nonregulated activities.[55]

Ameritech strongly disagrees with both the conclusion and tone of this finding. The audit team provides no evidence to support this overbroad assertion, other than a "quote" from an ASI employee that identifies neither the party nor the context in which the statement was made. The audit team then uses that "quote" to conclude that ASI "disregards" the reasonable allocation of new products and services. Use of such terms as "biased" and "disregard" without providing any supporting facts is further evidence that the audit team fails to provide a reasoned basis for its findings.

[53] The costs in this shared pool are allocated 99.8 % to regulated operations and .2 % to nonregulated operations.

[54] SCOUT is an on-line system intended to identify information relating to Ameritech's competitive environment, and APROMS stands for Ameritech Procurement Management System. ACIS is Ameritech Customer Information System.

[55] Report at page 8,23.

At all times, ASI allocates its costs in accordance with the FCC's cost allocation and affiliate transaction principles to ensure that the AOCs comply with the Commission's rules. What the audit team fails to recognize is that the overwhelming majority of the services that AOCs provide are regulated services. And, ASI, as a subsidiary of the AOCs, was formed to support these efforts and therefore it is perfectly logical, legitimate, and reasonable that a majority of ASI's costs are also regulated expenses.

Based on the foregoing, Finding 3 is not supportable.

VI. Finding 4: ASI Appropriately Assigned the Costs of The SMDS Trial.

The audit report erroneously finds that the costs of the SMDS/ATM trial should have been assigned to the nonregulated jurisdiction. Specifically, the audit team claims that AADS was formed based on knowledge gained from the trial.

Ameritech strongly disagrees with this finding, and the conclusion that AADS was formed based on knowledge obtained from the trial. As was explained to the auditors, the SMDS trial in Michigan was conducted to determine the technical and operational feasibility of deploying SMDS technology as a component of the public switched network.[56] Thus, the study focused on the compatibility of SMDS and the public switched network. Based on those objectives, the costs of the trial were appropriately assigned to regulated cost pools.

Despite having conducted the trial, Ameritech formed AADS, a separate corporate entity, to offer SMDS services for a variety of reasons unrelated to the findings of the trial. The reasons for this decision were threefold: 1) to accommodate the needs of customers in nonfranchised areas; 2) to address the need for pricing flexibility to assure competitiveness; and 3) to offer both network and premises equipment through a single accountable entity. None of these objectives would have been attainable if SMDS was offered as part of the public switched network.

In the report, the audit team fails to even mention that ASI has already provided an explanation as to why the costs of the trial were allocated to regulated operations, i.e., that the trial was designed to study deployment of SMDS technology in the public switched network. In fact, in accordance with the cost allocation and affiliate transaction rules, the AOCs transferred to AADS the switch used in the trial in 1993.[57] In order to justify its finding, the

[56] See response to FCC data request November 10, 1993, Question 2, A. Wiecki follow-up.

[57] The PSCW was aware of the asset transfer and that the amount was below the statutory minimum requiring PSCW approval.

report must address all the evidence it received during the audit and explain why that information is, or is not, persuasive. Without such an explanation, Finding 4 is not supportable. However, if the audit team provides further explanation to support this finding, Ameritech must be given an opportunity to respond.

VII. Finding 5: ASI Recorded the Costs of the PCS Trial to the Correct Part 32 Account and Appropriately Assigned the Costs of the PCS Trial.

The report claims that the costs for the PCS trial were improperly allocated to Account 6535, Engineering Expense, when the costs should have been allocated to Research and Development, Account 6727. [58] This conclusion is wrong and unsupported. First, as will be explained below, ASI appropriately classified and allocated the costs of the PCS trial. In this regard, ASI's portion of the PCS trial costs were to develop the interface between the public switched network and the PCS system. And, Account 6535, Engineering Expense states that the account should include costs "incurred in the general engineering of the telecommunications plant" and which include "developing input to the fundamental planning process, performing preliminary work or advance planning in connection with potential undertakings...." Since ASI's part of the PCS trial involved the development of the public switched network for the PCS interface, based on this definition, it is entirely appropriate to allocate the costs to that account. In fact, the report provides no explanation as to why it is more appropriate for ASI to classify these costs as research and development rather than engineering expense.

Furthermore, the report provides no justification for concluding that ASI improperly failed to classify costs to Research and Development. In this regard, other than the above example, the report makes no finding that other costs incurred by ASI should have been classified to Account 6727. Specifically, it is ASI's position that it does not do research and development as defined in Part 32 because ASI focuses it efforts on using the research and development performed by such entities as Bellcore, universities, and our vendors, in specific product development and general corporate planning support. Consequently, without more facts supporting the statement that ASI failed to classify costs to Research and Development, this unsupported conclusion is without merit.

The report incorrectly concludes that ASI improperly allocated the costs of the PCS trial to a shared cost pool, when those costs should have been directly assigned to nonregulated operations. Specifically, the audit team leaps to the conclusion that since "some aspects of the project could potentially fall into

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[58] Report at page 24.

the category of the enhanced services," PCS services are enhanced and should be directly assigned to nonregulated activities.[59]

But, this reasoning does not stand up under scrutiny. First, the audit team incorrectly characterizes ASI's portion of the PCS trial as a study of the entire technical and marketing study of PCS services. But, ASI was involved in only a portion of the PCS trial. Specifically, ASI's involvement was limited to examining the feasibility of an improved public switched network to support multiple PCS providers through an open interface. In fact, this aspect of the trial resulted in the development of a new access service for which the AOCs have received a patent from the U.S. Patent Office. And, the audit team knew about -- but ignored -- the limited focus of ASI's involvement, through its copy of ASI's presentation on "Personal Communications Services, Intelligent Network Funding Request."[60] That presentation mentions specifically "[t]he purpose of the Ameritech Direct/PCS Trial is to demonstrate that the Public Switched Network can be used as the backbone for PCS services."[61]

While ASI was focusing on the interface between the public switched network and PCS service providers, Ameritech Corporation was responsible for studying the marketability of total PCS services. The cost of this portion of the trial was controlled and paid by Ameritech Corporation and was completely allocated to nonregulated activity. These costs were over $5 million during 1992, and were never even recorded on ASI's books.[62] Thus, the majority of the PCS trial costs were allocated to nonregulated through Ameritech Corporation and only those costs involved in developing the access service to the public switched network were in ASI's budget.

In fact, it is more than likely that the PCS access services which were the focus of ASI's trial would be treated as regulated, and therefore should have been assigned to a regulated cost pool, but in an over abundance of caution, ASI's PCS trial costs were allocated to a shared cost pool. Moreover, Ameritech's treatment of the PCS trial costs, i.e., splitting them between Ameritech Corporation (nonregulated) and ASI (shared), is entirely consistent with the quote in the report which states that "Ameritech believes it is likely that PCS will be defined by regulatory bodies as a competitive service."

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[59] Report at page 24-25.

[60] See OBGP Presentation Document "Personal Communications Services, Intelligent Network Funding Request" dated September 24, 1991, given to the audit team on March 19, 1993.

[61] Id. at page 4.

[62] These amounts are new information to the audit team.

Furthermore, the audit team provides no justification for concluding that PCS services will be enhanced. As support for the fact that PCS services might be enhanced, the report includes an alleged statement made by an employee that PCS services might "potentially" be enhanced. But, the report fails to cite the individual or the context in which this statement was made. And, regardless of this statement, the FCC itself has not defined how PCS service will be treated for regulatory purposes. Even though the FCC may define these services as competitive services, that fact still does not mean those services will not be regulated. There are many examples in which services are defined as competitive, yet remain regulated depending upon which carrier is providing the service. In fact, in many instances PCS may be used to provide voice services which are traditionally regulated, and the FCC may choose to maintain some regulatory control over those types of services.[63]

What the audit team essentially argues in Finding 5 is that carriers must allocate all costs to nonregulated activities if those activities may potentially -- at some future undefined date -- become nonregulated. But that is not what the Part 64 rules require.[64] Rather, the rules require that product development costs be allocated between regulated, nonregulated and shared cost pools based on the type of project involved. Since Ameritech demonstrated that ASI's costs for the PCS trial related to access services with the public switched network, it was reasonable for the costs to be allocated to a shared cost pool.

Finally, in this finding, the report references that ASI only directly assigned two work profiles to nonregulated cost pools, and did not directly assign any work profiles which involved the development of future products to nonregulated operations. This language should be removed because it is overbroad and is not related to the audit team's finding regarding the PCS trial. Clearly this language is meant to imply that ASI does not properly allocate its costs, and again raises questions about the objectivity of the audit team's analysis.

VIII. Finding 6: ASI Lease of Space at the Ameritech Center does not Violate Any FCC Rule.

[63] See Personal Communications Service (PCS) Analysis and Validation, Bellcore, Special Report, SR-INS-002148, November 1991, provided to the audit team on March 19, 1993.

[64] The PSCW made this same argument in its Ex Parte Comments filed in the FCC's proceeding to amend the affiliate transaction rules. See Amendment of Parts 32 and 64 of the Commission's Rules to Account for Transaction between Carrier and Their Nonregulated Affiliates, CC Dkt. No. 93-251, Comments of the Public Service Commission of Wisconsin, filed May 13, 1994.

In Finding 6, the audit team erroneously concludes that ASI leased excess space at the Ameritech Center, which cost the AOCs an additional $30 million. The audit team claims that the lease of this excess space, together with the statement that ASI plans on leasing that space to nonregulated affiliates, violated the Commission's used and useful standard.[65]

Finding 6 is unsupportable for a number of reasons. First, this finding goes beyond the scope of the audit. Specifically, the audit was to determine whether ASI allocated its costs to ensure AOC compliance with the Commission's Part 32 and Part 64 rules, and whether the ratepayers were adversely impacted by any noncompliance. The audit team implies that ASI's lease costs at the Ameritech Center did not comply with Part 32 and Part 64.

Second, the report provides no support for applying a 'used and useful' standard to expenses. In this regard, during a ratemaking proceeding, carriers are traditionally allowed to include in the ratebase those investments which are 'used and useful.' On the other hand, carriers are allowed to recover expenses through rates, if they are reasonable. Since this is not a ratemaking proceeding, and ASI's leased costs are not investments but expenses, this finding is irrelevant.

Finally, ASI opposes this finding because many of the facts on which the finding is based are inaccurate. Specifically, the finding stated that ASI increased the amount of square footage it leased and this increased square footage resulted in a $30 million increased lease cost to ASI and the AOCs.

Ameritech needed adequate room to house its employees in one contiguous office space, and therefore needed to build a new facility.[66] Research found that no existing office complex in the Chicago area had adequate room. The Center opened in 1991, and was in various stages of completion during the audit. All space at the Center was claimed in differing amounts by ASI, Ameritech Mobile and other nonregulated affiliates. The rents were phased in as the space became occupied, and all tenants pay the same amount of rent per square foot.

As the Center became ready for occupancy, ASI employees moved in from ASI or AOC/Corporate leased space. ASI moved all its employees from its leased space. If the lease had expired near the move date, no additional costs were incurred. But if the lease still had a number of years remaining, lease termination costs were incurred. In addition, certain transition occupancy expenses occurred when the date to move employees and the termination

[65] Report at page 25 through 28.

[66] June 5, 1992 data request Question 6(h); Robert Dunklau letter to Jim Wegman; see also handout provided during January 25 - 28, 1993 on-site visit.

date of the lease were different. In these situations, it was cheaper to pay the remaining lease than to incur termination costs. This occurred in two locations: 500 W. Madison, Chicago, and the Gould Center, Rolling Meadows. For these two locations the transition cost adjustments totaled $0.7 million in 1991, and $1.5 million in 1992;[67] and not the $ 9.7 million and $7.0 million, respectively, claimed by the audit team as double occupancy.[68] For those ASI employees moving from AOC/Corporate leased space, ASI occupancy costs ended on the date they moved and began at the Center. Therefore, there were no transition and occupancy expenses incurred for these employees.

At the Center, ASI pays only for the space it occupies and some additional space for planned growth. Large lease holders, such as Ameritech Mobile and Ameritech Information Systems, are billed directly for their space, while smaller nonregulated subsidiaries reimburse ASI for their lease costs. In any event, as noted above, all parties pay the same square foot rate for leased space.

Furthermore, the square footage ratios cited in the report are misleading. Specifically, the headcount figures used in the report do not include contract employees. ASI uses a significant number of contract employees and needs to provide them with work space, which the audit team should have considered in its calculation. In addition, the audit team's square footage figures include an allocation to ASI for common space. When the square footage for the Conference Center, dining facilities, regional library, and wellness center, are removed, and an ASI headcount including contract employees is used; an appropriate calculation, for comparison purposes, of ASI's real square foot per employee becomes 368 square feet -- significantly smaller than the report's 551 square feet.[69] Moreover, ASI's headcount for 1994 has increased to 2506 employees (including contract employees). When the Center's 761,000 square feet (excluding the conference center, dining facilities, regional library, and wellness center) is divided by the current number of employees, ASI's square foot per person becomes 304 square feet.

Furthermore, there are significant inaccuracies in the numbers provided in the audit team's analysis. Specifically, the lease termination costs shown in 1991 of $7.6 million were incurred in 1992. In addition, the $7.6 million is also not an accurate reflection of the actual lease termination costs recorded on ASI's books. In this regard, the $7.6 million represented the total lease termination costs for the Ameritech Corp., but only $3.9 million was recorded

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[67] This represents new information.

[68] See Report at page 28, adjusted occupancy chart.

[69] See Exhibit 10, for a calculation of the square footage.

on ASI's books with the remainder on Corporate's books. Thus, the more appropriate number for ASI's termination costs is $3.9 million.[70]

Another inaccuracy in the report is that ASI paid $9.7 million in 1991, and $7.0 million in 1992 in double occupancy costs. The report claims that costs of the Ameritech Center during those years before employees began to occupy the building were double occupancy costs. But, ASI demonstrated that it realized transition occupancy costs, of $ .7 million and $ 1.5 million in 1991 and 1992, respectively, and did not pay rents on any leased space or AOC space once employees were moved to the Center. Thus, ASI did not incur "double occupancy" costs as the report claims.

Based on the foregoing, Ameritech has demonstrated that the costs of the Ameritech Center are irrelevant to whether the AOCs complied with Part 32 and Part 64 rules, and therefore this finding is unsupportable. In addition, Ameritech has demonstrated that the report's alleged $30 million dollars increase in leased expenses is incorrect. First, if the report reflected the correct timing of the termination costs in 1992, and not 1991, and correct amount of the termination costs that ASI booked of $ 3.9 million; then the increase is lowered to $ 18.5 million. Second, if the report reflected the fact that ASI had $ 0.7 million, $ 1.5 million, and $ 0.1 million in transition costs over 1991, 1992, and 1993, respectively, and not the double occupancy amounts included in the report; then the increase is lowered to $ 13.5 million. And, based on the rate of inflation, that increase is reasonable. So again, this finding is not supportable.

IX. Finding 7: Ameritech Publishing, Inc. Should Not Have Been Billed for $142,000.

Finding 7 states that ASI failed to bill Ameritech Publishing, Inc. (API) for some costs of developing a bill insert which amounted to $142,000. When the audit team first approached ASI with this question, ASI responded that it would send a bill to API which it did.

Upon further investigation, however, it was discovered that the costs of this bill insert were already recovered by the AOCs through the API billing contract and the sum certain amount paid annually to the AOCs by API. Specifically, the contract between the AOCs and API includes provisions whereby the AOCs will bill and collect yellow pages listings for API. This agreement to bill and collect for API includes the cost of preparing and rendering the bill.[71] Thus, because ASI prepared the bill page for API, on

[70] This is new information for the audit team.

[71] Agreement between API and each of the AOCs, ¶ 3.1, and "Guidelines for the Provision of Billing and Collection Services between (AOC) and Ameritech Publishing, Inc.," at Section II.C. "Bill Rendering Service", dated February 21, 1991. This is new information to the audit

behalf of the AOCs, it was appropriate for ASI to bill only the AOCs for the cost of developing the bill page.

In any event, because of the confusion regarding this answer, ASI will take the $ 142,000 amount below the line. Consequently, because ASI did not allocate the costs for this work project improperly and ASI is also taking the costs below the line, this finding is not supportable.

X Portions of the Report are Irrelevant and Should Be Removed.

Finally, in a number of instances the report includes discussions that are irrelevant to ASI's cost accumulation and allocation procedures.

A. The Report's Discussion on ASI's Cost Reduction Measures is Irrelevant.

The report discusses at length Ameritech Corporation's savings from reduction of staff. In that discussion, the audit team concludes that it cannot determine whether the ratepayers benefited from the expense reduction.[72] Clearly, that discussion is beyond the objectives of the audit, which were to review ASI's accounting practices to determine the AOCs' ability to comply with the Commission's rules, and whether noncompliance adversely affected ratepayers.[73] Ameritech's attempts to reduce expenses are unrelated to whether the AOCs comply with the cost allocation and affiliated transaction rules. In fact, nowhere in the report does the audit team even attempt to tie the reduction in expenses to compliance with Part 32 and Part 64 of the Commission's rules. Rather, reduction in expenses and their impact on the ratepayers are issues more appropriately raised in a rate proceeding, and given the price cap environment completely irrelevant.[74] Thus, this discussion should be removed.

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[72] Report at page 20.

[73] Report at page 4.

[74] The report states that AOCs' expenses grew at a rate "approximately equal" to the rate of inflation. As point in fact, AOC expenses grew at less the rate of inflation when adjusted for the one time SFAS 106 expenses which were booked in 1992.

	Inflation Index GNP-PI	Adjusted AOC expense - % change
1991	4.05%	2.16 %
1992	3.30%	2.45 %
1993	3.09%	2.78 %

Exhibit 1

B. The Report's Discussion on Material Logistics is Irrelevant.

Finally, an additional irrelevant fact is the audit team's statement that business process 05 be further reviewed. Since the audit team did not review the costs assigned to this business process -- which it admits in the report -- any statement regarding it is irrelevant to the findings in the report and should be removed.